

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION E-3914

April 21, 2005

R E S O L U T I O N

Resolution E-3914. Pacific Gas and Electric (PG&E) requests the Commission's authorization to establish a memorandum account to track and record costs associated with new long-term resource procurement activities.

By Advice Letter 2597-E Filed on December 10, 2004.

SUMMARY

This Resolution approves, as modified, PG&E's request to establish a new memorandum account to track and record costs associated with long-term resource procurement activities.

BACKGROUND

PG&E proposes to track costs associated with procuring long-term resources, either through the acquisition of utility generation facilities or through the execution of long-term procurement contracts.

PG&E personnel in the Power Generation and Power Contracts and Electric Resource Development organizations, external consultants, and outside legal support would perform activities associated with long-term resource procurement.

PG&E states that the range of these activities were not envisioned in the 2003 GRC, Exhibit 15, because at the time PG&E did not have long-term contracting authority for general procurement and thus, was only planning for short-term procurement transactions. PG&E also did not believe new generation was needed within the horizon covered by the GRC.

PG&E states that the proposed memorandum account will track the costs associated with PG&E's new long-term procurement activities as authorized in Decision (D). 04-01-050 through 2006. Costs incurred in 2007 and beyond will be included as part of PG&E's base revenue requirement request in PG&E's next GRC application.

Specific activities identified by PG&E associated with long-term resource procurement include, but are not limited to:

- Development, preparation and administration of Request for Offer (RFO) (contract and ownership)
- Offer evaluation and selection
- External review of development process (which includes engineering, construction, procurement, transmission, and permitting)
- Due diligence on existing facilities and existing contracts (e.g., QF and repowering)
- External legal review
- Contract negotiation and structuring
- Evaluation of bidder qualifications
- Regulatory approval
- Oversight of project development to ensure timely delivery
- Market power studies required for project approval
- Any additional activities as PG&E's role is further defined in R.04-04-003 (e.g. Independent Third-Party Evaluator review)

Prior to PG&E's next GRC Application, PG&E proposes to recover costs recorded in the memorandum account as part of PG&E's filings requesting Commission approval of its long-term resource commitments. Upon Commission approval of the filings, PG&E proposes to record and recover the costs in the Energy Resource Recovery Account (ERRA).

PG&E cites Section 4.11 of the 2003 GRC Settlement Agreement, approved in D. 04-05-055, in filing the AL. The cited section reads in part "...The Settling Parties understand that the Commission is considering integrated resource and procurement issues in R.01-10-024 and that the Commission will further define PG&E's role in this area which may affect costs. The Settling Parties reserve their rights to address such issues in other proceedings, as the role of utilities in this area is further developed by the Commission."

NOTICE

Notice of AL 2597-E was made by publication in the Commission's Daily Calendar. PG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

PG&E's Advice Letter AL 2597-E was timely protested by the Office of Ratepayer Advocates (ORA), Aglet Consumer Alliance (Aglet), and The Utility Reform Network (TURN). ORA filed its protest on December 29, 2004. Aglet and TURN filed their protests on December 30, 2004.

PG&E responded to the protests of ORA, Aglet, and TURN on January 5, 2005.

The following is a more detailed summary of the major issues raised in the protests.

ORA, Aglet, and TURN raise concerns that an approval of this AL will circumvent the traditional test year ratemaking process.

ORA states that the GRC revenue requirement adopted by the Commission in D.04-05-055 provided funding for PG&E's entire operations for the term of the GRC period through 2006. The decision also provided PG&E with additional attrition rate increases in the intervening years of 2004, 2005, and 2006 prior to the next GRC. ORA argues that PG&E's allegation that the range of activities was not envisioned in the 2003 GRC is no basis for providing a utility authorization to separately track incremental expenses associated with one particular cost function. ORA states that there is never perfect accuracy within a GRC revenue requirement estimate, but it is an overall budget, which provides adequate funding for the utilities total (distribution and generation) operations for the term of the GRC period.

ORA further states that the incremental costs are simply a part and parcel of PG&E's on-going operations. Any increase (and decrease) in expenses beyond those forecast in the 2004 GRC proceeding will ultimately be considered and reflected in the next PG&E GRC filing.

ORA also finds the AL defective as there is no factual support for the assertion that the costs PG&E seeks authority to track are in excess of the GRC approved revenue requirement. ORA states that simply because a cost is a new cost does not necessarily correlate to a cost that is in excess of the GRC approved revenue requirement. ORA states that there are always new costs incurred that may not have been considered as well as other “old or forecast” costs that were not ultimately incurred by the utility.

Aglet (with TURN joining and supporting the arguments) states that PG&E’s request is contrary to test year ratemaking. Aglet argues the request is one sided as rates can only go up. That PG&E seeks to protect shareholders against the possibility that it will spend more money than the Commission authorized, but does not offer to protect ratepayers against the possibility that some activities that underlie PG&E’s authorized revenue requirements will not be necessary.

ORA and TURN raise objections to use of an Advice Letter as a proceeding.

ORA argues that the establishment of a memorandum account is an initiation for a rate increase and as such a formal application should be filed in conformance to Commission General Order No. 96-A. TURN questions whether an AL filing qualifies as a proceeding.

ORA also argues that PG&E’s use of the Advice Letter filing is not akin to addressing the issue(s) in a proceeding. ORA state that if PG&E wishes to imitate a proceeding, then it should file an application.

PG&E reiterated its position in its response to the protest.

PG&E responded to all three protests under one response letter on January 6, 2005. In its response, PG&E maintained that its Advice Letter was consistent with the Commission-approved 2003 GRC Settlement Agreement and that the Advice Letter did not violate precedents regarding appropriate test year ratemaking. PG&E also responded that it was entitled to pursue prospective adjustments to its rates to reflect changes in its costs of service; that an Advice Letter filing was an appropriate means to seek authority to establish a tracking mechanism; and that a memorandum account was necessary to preserve PG&E’s right to seek future rate recovery.

DISCUSSION

PG&E's request to establish a long-term procurement memorandum account is approved with modifications. PG&E is authorized to track all 2005 and 2006 third party costs associated with long-term procurement activities. PG&E is also authorized to track incremental internal labor costs in 2005 and 2006 that exceed \$2.5 million. Incremental internal labor costs booked to the memorandum account will not exceed \$2 million per year. PG&E will file an application to seek recovery. In its application, PG&E should be prepared to demonstrate that the newly authorized long-term procurement activities resulted in PG&E expenses exceeding the approved 2003 GRC revenue requirement and attrition increases.

Draft resolution is modified to provide PG&E with equal treatment for long-term procurement costs, relative to other utilities

The draft resolution, as mailed for comments, denied PG&E's request to establish a memorandum account to track long-term procurement costs. That denial was based on several factors. Those factors, while continuing to remain valid, did not include how the Commission would address other utilities concerning similar issues. Specifically, in Southern California Edison's (SCE) GRC, SCE included its long-term procurement costs in its revenue requirement request (A.04-12-014). While the Commission has yet to decide on the merits of SCE's request, the fact that SCE has included the long-term procurement costs in its GRC request would indicate an unequal treatment should PG&E's request to establish a memorandum account to track long-term procurement costs be denied. That is, PG&E did not have an opportunity to present its long-term procurement costs for consideration by the Commission, while SCE did have that opportunity. Simply because PG&E's GRC was completed before SCE's should not prevent PG&E from receiving the same opportunity to present its case. The memorandum account would allow PG&E to track its long-term procurement costs, thereby preserving PG&E's ability to present its case.

The establishment of a memorandum account does not presume cost recovery

The memorandum account will track authorized long-term procurement costs and preserve PG&E's ability to seek recovery. Recovery, however, is not guaranteed nor assured. PG&E will need to demonstrate to the satisfaction of all parties that the tracked costs are in fact incremental to what was included in the 2003 GRC.

Other parties retain right to challenge recovery of costs in the long-term memorandum account

Establishment of a memorandum account by PG&E does not limit the rights of other parties to challenge the recovery of costs tracked in the memorandum account in a future proceeding. As PG&E points out in its comments, other parties will have a full opportunity to address the policy of cost recovery, as well as the amount of the costs at the future proceeding.

PG&E presents an alternative that would result in sharing long-term procurement costs

In its comments to the draft resolution, PG&E maintains that the Settlement Agreement provided PG&E an opportunity to request recovery of long-term procurement costs and that an advice letter filing was an appropriate instrument. PG&E's comments also states that the draft resolution incorrectly concluded that the memorandum account would shift risks from shareholders to ratepayers. PG&E concluded its comments by presenting an alternative that would result in a sharing of the long-term procurement costs. The alternative was for PG&E to absorb (i.e., not book to the memorandum account) \$2.5 million each for 2005 and 2006 for PG&E's incremental labor costs. Labor costs booked to the memorandum account could also be capped at \$2.0 million per year to limit the potential cost impact on customers from PG&E's labor costs. Under this compromise, PG&E would be permitted to book all third party costs associated with long-term procurement activities, such as costs for the independent evaluator and for external engineering, environmental, and transmission reviews and studies and the costs for. Parties will have a full opportunity to challenge recovery of amounts recorded in the memorandum account when PG&E seeks such recovery and requests approval of its long-term resource acquisitions.

PG&E's proposed compromise protects ratepayers from unlimited internal costs and preserves PG&E's opportunity to present its case for cost recovery of long-term procurement costs

PG&E's compromise is acceptable. The compromise protects ratepayers from unlimited internal costs, preserves the rights of other parties to challenge cost recovery, and allows PG&E to receive equal treatment before the Commission for long-term procurement costs.

In its application seeking recovery, PG&E should be prepared to demonstrate that authorization for long-term procurement activities would lead to administrative expenses in excess of the approved GRC revenue requirement

PG&E states in its Advice Letter that the "... Settlement Agreement in its 2003 GRC provides an opportunity to seek recovery of procurement-related administrative expenses in excess of the GRC approved revenue requirement..." However, as ORA points out, simply because a cost is a new cost does not necessarily correlate to a cost that is in excess of the GRC approved revenue requirement. It is simply a new cost incurred between GRC proceedings. There can be new costs incurred that may not have been considered, but also other "old or forecast" costs that were not ultimately incurred by the utility.

Additionally, while PG&E provided a list of activities that its Power Generation and Power Contracts and Electric Resource Development organization, external consultants, and outside legal support will perform under the long-term procurement authority, PG&E did not address how these activities may affect costs. As TURN points out "...long-term procurement is not a fundamentally different activity from short term procurement – many of the same procedures and personnel are involved in the activity, regardless of the term of the contracts that are being solicited. Indeed, one could reasonably argue that, having been granted authority to enter into longer-term deals, PG&E's administrative costs may actually decrease, because larger blocks of power will be purchased for longer periods of time, thereby reducing the work required to process many smaller shorter-term transactions."

PG&E should be prepared to provide a balanced picture. PG&E should provide support that the authority to enter into long-term procurement has caused the procurement-related administrative expenses to exceed the GRC approved revenue requirement. PG&E should also be prepared to demonstrate how the long-term procurement activities have impacted the forecasted costs embedded in the GRC. In short, PG&E should be prepared to demonstrate that administrative expense increases and decreases have exceeded the approved 2003 GRC revenue requirement and attrition increases.

PG&E's request to establish a memorandum account to track long-term procurement costs is approved as modified.

COMMENTS

Public Utilities Code section 311(g) (1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g) (2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments. Comments are due on April 6, 2005. Reply comments are due on April 13, 2005.

PG&E provided comments to the draft resolution on April 6, 2005. No other party provided comments. No parties provided reply comments to the draft resolution.

In its comments, PG&E states that draft resolution ignores the provisions of the 2003 distribution settlement allowing PG&E an opportunity to request recovery of these costs. PG&E further states that the draft resolution incorrectly concludes that establishing a memorandum account inappropriately shifts risks from shareholders to ratepayers. PG&E concludes its comments with an alternative proposal to share the long-term procurement costs.

Based in part on PG&E's comments and alternate proposal, the draft resolution is being modified. Modifications to the draft resolution have been incorporated throughout as reflected herein.

FINDINGS

1. PG&E filed Advice Letter 2597-E on December 10, 2004.
2. Advice Letter 2597-E sought authority to establish a new memorandum account to track costs associated with new long-term resource procurement activities.
3. PG&E states that the costs to be recorded were not included in PG&E's 2003 General Rate Case (GRC) or in the GRC Settlement Agreement base revenue requirement.

4. PG&E states that the 2003 GRC Settlement Agreement provided an opportunity to seek recovery of procurement-related administrative expenses in excess of the GRC approved revenue requirement.
5. Advice Letter 2597-E was timely protested by the Office of Ratepayer Advocates (ORA), Aglet Consumer Alliance (Aglet), and The Utility Reform Network (TURN).
6. ORA, Aglet, and TURN protests that the approval of the Advice Letter will circumvent the traditional test year ratemaking process.
7. ORA and TURN object to the use of an Advice Letter as a proceeding.
8. PG&E timely responded to the protests.
9. The draft resolution denied PG&E's request based on several factors.
10. The draft resolution did not consider how the Commission would address similar issues for other utilities.
11. SCE included its long-term procurement costs in its revenue requirement request to the Commission (A.04-12-014).
12. PG&E has not yet had an opportunity to present its long-term procurement costs for consideration by the Commission.
13. The memorandum account would allow PG&E to track certain long-term procurement costs, thereby preserving PG&E's ability to present its case, and receive an equal treatment before the Commission.
14. PG&E provided comments to the draft resolution on April 6, 2005.
15. In its comments, PG&E presented an alternative that would result in a sharing of the long-term procurement costs.
16. PG&E proposes to absorb \$2.5 million per year for 2005 and 2006 for PG&E's incremental labor costs.
17. PG&E's incremental labor costs booked to the memorandum account would be capped at \$2.0 million per year.
18. PG&E would be permitted to book all third party costs associated with long-term procurement activities into the memorandum account.
19. Parties will have a full opportunity to challenge recovery of amounts recorded in the memorandum account when PG&E seeks recovery.
20. The compromise protects ratepayers from unlimited internal costs, preserves the rights of other parties to challenge cost recovery, and allows PG&E to receive equal treatment before the Commission.
21. In its application seeking recovery, PG&E should be prepared to demonstrate that authorization for long-term procurement activities would lead to administrative expenses in excess of the GRC approved revenue requirement.
22. The protests of ORA, Aglet, and TURN are denied.

THEREFORE IT IS ORDERED THAT:

1. The request of the PG&E to establish a memorandum account to record costs associated with long-term procurement activities as requested in Advice Letter 2597-E is approved as modified as follows.
 - a. PG&E shall absorb \$2.5 million per year for 2005 and 2006 for PG&E's incremental labor costs.
 - b. PG&E's incremental labor costs booked to the memorandum account shall be capped at \$2.0 million per year.
 - c. PG&E shall be permitted to book all third party costs associated with long-term procurement activities in 2005 and 2006 into the memorandum account.
 - d. Parties shall have a full opportunity to challenge recovery of amounts recorded in the memorandum account when PG&E seeks recovery.
2. Within 10 days of today's date PG&E shall supplement AL 2597-E to modify the tariff language in its proposed memorandum account so that it specifies the terms and conditions approved by this resolution. The supplemental advice letter shall be effective on today's date subject to Energy Division determining that it is in compliance with this order.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on April 21, 2005; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
GEOFFREY F. BROWN
SUSAN P. KENNEDY
DIAN M. GRUENEICH
Commissioners